In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 848

WILLIAM F. WARD and CARRIE D. WARD, PETITIONERS

v.

UNITED STATES OF AMERICA

KENNEDY W. WARD and AUDREY P. WARD, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (Pet. App. 1a-12a) is reported at 428 F. 2d 1288.

JURISDICTION

The judgment of the Court of Claims was entered on July 15, 1970 (Pet. App. 1a, 12a). The petition

for a writ of certiorari was filed on October 13, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Whether petitioners are entitled to a deduction for a casualty loss of property in which, at the time of such loss, they had no basis.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 165, 1011, 1012 and 1016 of the Internal Revenue Code of 1954 and Sections 1.165-1(c)(1) and 1.165-7(b)(1) of the Treasury Regulations on Income Tax (1954 Code) are set forth in the Appendix, *infra*, pp. 6-7.

STATEMENT

Petitioners William and Kennedy Ward[1] each owned an undivided one-half interest in 2,672 acres of land in Craven County, North Carolina. In April 1963, a fire burned almost the entire tract, ultimately resulting in almost total destruction of the pine timber located on the land. The decrease in fair market value of the timber resulting from the fire, less salvage, was $50,767. (Pet. App. 9a, 10a, 11a.)

During petitioners' ownership of the tract, the timber had substantially increased in amount and value through natural growth and the planting of

[1] Carrie and Audrey Ward are their respective wives and are parties hereto because joint income tax returns were filed for the year in issue.

small seedlings. Sporadic pulpwood and logging operations had been conducted on the tract in prior years, the income from which had been reported by petitioners for income tax purposes. Petitioners had no tax or cost basis remaining in the timber when the fire and resulting destruction occurred. (Pet. App. 10a.)

In their income tax returns for 1963, petitioners claimed the entire decrease in the fair market value of the timber as a deductible casualty loss under Section 165 of the Internal Revenue Code. The Commissioner disallowed the claimed deductions and assessed deficiencies totalling $5,278. (Pet. App. 11a.)

Petitioners paid the tax in dispute and, after their timely claims for refund were disallowed, brought the instant suit for refund. The Court of Claims dismissed the suit, holding (Pet. App. 6a) that "a casualty loss for destroyed timber 'that can never acquire a cost basis' can never be deducted from income under the pertinent revenue sections of the 1954 Code * * *."

ARGUMENT

The Court of Claims' decision is correct. There is no conflict or any other ground for further review.

1. Section 165 of the Code allows a deduction for a loss to property. The amount of the deduction is expressly limited by the statute (Section 165(b), Appendix, *infra*, p. 6) to the "adjusted basis provided in section 1011." Section 1011 and its related sections (Sections 1012 and 1016) define the "adjusted basis" of property as its cost, with adjustments for various capital account transactions not here rele-

vant. Since petitioners admittedly had a zero basis in their timber, they are not entitled to any casualty loss deduction even though the fair market value of their timber at the time of the loss and the decrease in fair market value as a result of the loss exceeded their adjusted basis. See Treasury Regulations on Income, Sections 1.165-1(c)(1) and 1.165-7(b)(1), Appendix, *infra*, p. 7; *Helvering* v. *Owens*, 305 U.S. 468; *Alcoma Ass'n* v. *United States*, 239 F. 2d 365 (C.A. 5); *Carloate Industries, Inc.* v. *United States*, 354 F. 2d 814 (C.A. 5); *Rosenthal* v. *Commissioner*, 416 F. 2d 491 (C.A. 2). As the Second Circuit explained in *Rosenthal* v. *Commissioner*, *supra* at 497:

> Manifestly, the purpose of Sec. 165 is not to allow the taxpayer a full deduction for every loss in market value his property suffers by reason of a casualty. The permissible deduction for such loss is always limited to the taxpayer's basis, or cost, in the property damaged. And the reason for this limitation is clear. Where the taxpayer suffers a loss from a destruction of market value greater than the cost of the property to him, that excess of value destroyed represents unrealized appreciation. And he may not claim a deduction for such loss because he has never recognized or paid a tax on the gain. In the extreme case, *where the taxpayer's basis in the property damaged is zero, and its entire market value represents unrealized appreciation, he is entitled to no deduction despite the size of the loss, large as it may be.* Consequently, taxpayers' argument that the Commissioner's result, by limiting the amount of their deduction to less than the full amount of their loss, would defeat

the purpose of § 165 is simply incorrect. [Emphasis supplied.]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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NOVEMBER 1970.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 165. LOSSES.

(a) *General Rule.*—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(b) *Amount of Deduction.*—For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

* * * *

SEC. 1011. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under section 1012 * * *), adjusted as provided in section 1016.

* * * *

SEC. 1012. BASIS OF PROPERTY—COST.

The basis of property shall be the cost of such property, except as otherwise provided * * *.

* * * *

SEC. 1016. ADJUSTMENTS TO BASIS.

(a) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(1) for expenditures, receipts, losses, or other items, properly chargeable to capital account * * *.

* * * *

Treasury Regulations on Income Tax (26 C.F.R.):

SEC. 1.165-1. LOSSES.

* * * *

(c) *Amount deductible.* (1) The amount of loss allowed as a deduction under section 165(a) shall not exceed the [prescribed] amount^ by § 1.1011-1 as the adjusted basis for determining the loss from the sale or other disposition of the property involved. * * *

* * * *

SEC. 1.165-7. CASUALTY LOSSES.

* * * *

(b) *Amount deductible.* (1) *General rule.* In the case of any casualty loss * * *, the amount of loss to be taken into account for purposes of section 165(a) shall be the lesser of either—

(i) * * * [The loss in fair market value]; or (ii) The amount of adjusted basis prescribed in § 1.1011-1 for determining the loss from the sale or other disposition of the property involved.

* * * *

CERTIORARI DENIED

N.C.R.